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RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR OF THE EXCHEQUER
AND THE FEDERAL GERMAN FINANCE MINISTER IN THE FEDERAL FINANCE
MINISTRY IN BONN AT 6 PM ON 28 OCTOBER 1982

Present:-

Chancellor	Dr. Gerhard Stoltenberg
Sir Kenneth Couzens	Dr. Horst Schulmann
Mr. P.W. Unwin (HM Embassy, Bonn)	Dr. Pieske
	Dr. Heck
Mr. J.O. Kerr	Herr Schmidt
	Frau Wittler

FRG, UK, and world economy

Dr. Stoltenberg referred to the new government's economic inheritance, which was worse than they had foreseen. The latest economic forecasts had reduced the growth assumption for 1983 from 3 per cent to nil, and the estimate of tax revenue by DM9.3 billion, while average unemployment throughout 1983 was now put at 2.35 million, instead of the 1.85 million which had been the June forecast. Thus, though making cuts of over DM5.6 billion on their predecessors' 1983 spending plans, the new government were still obliged to contemplate a deficit higher, at some DM41.5 billion, than they had in opposition thought right. Some tax increases were envisaged, though the government was determined to reduce the fiscal burden on trade and industry in the medium term. The level of investment expenditure for 1983 was being increased, and some new incentives introduced, but the process of securing economic revival would, given the world economic picture, be a long haul, with the positive effects of new policies not expected to come through until the second half of 1983.

2. The Chancellor referred to parallels with the 1979 inheritance in the UK, and between the approach of the FRG and UK governments. In 1979 the UK government had inherited a rapidly rising inflation rate, and a large and expanding public sector deficit, and had been



determined to control inflation, monetary growth, and borrowing. Borrowing had been reduced from 6 per cent to 3 per cent of GDP. Inflation had come down from a peak of 22 per cent to some 7.3 per cent, and should be down to 5 per cent by spring 1983. By summer 1981 it had been clear that the bottom of the recessionary trough had been reached, but the expected steady growth had been checked last winter, not least because of the autumn rise in interest rates. We had previously forecast growth of $1\frac{1}{2}$ per cent this year, but the actual outturn was likely to be only some 0.6 per cent. We now hoped for some $1\frac{1}{2}$ per cent growth next year, though - as in Germany - much would depend on some resumption of world growth. The annual public expenditure review was complete, and the planned totals for 1983-84 would be held. The PSBR for the current year was likely to be below forecast, largely as a result of the rapid progress against inflation.

3. Dr. Stoltenberg noted that the UK had gone into a recession rather earlier than had the FRG, and could therefore expect also to come out rather earlier. There would be negative growth in Germany in 1982, and not before the second half of 1983 was a positive figure expected. Thus the FRG seemed likely to undergo in 1982 and 1983 what the UK had experienced in 1980 and 1981. He was impressed that the UK 1982-83 PSBR would be only some 3 per cent of GDP: the comparable figure for the FRG would be around 5 per cent. It would be important to reduce it in future years. Following the March election he hoped to be in a position to introduce further and more radical spending cuts, designed to reduce the structural deficit. Public opinion was in fact rather more ready to contemplate decisive action of this kind than the spokesmen of the various interest groups who would be affected were prepared to admit.

4. The Chancellor agreed. Given inevitable domestic sensitivities in all countries facing the problems, e.g. of rising social security costs, it was unfortunate that very little effort had so far been made to encourage international institutions to comment on these



problems in a way which would influence the domestic debate. Secretary Regan's predicament over US "entitlement" programmes was a case in point. In the Chancellor's view, Regan, like the UK and FRG governments, recognised the need to reduce expenditure, and so borrowing, but had as yet proved unable to deliver. The high level of the current, and prospective, US deficit carried a risk that, despite the recent and sensible adjustment in US monetary policies, US, and hence world, interest rates would stay high, thus threatening the prospect of world growth. It would be helpful if Chancellor Kohl could raise this issue with President Reagan during his forthcoming visit to Washington. Since all three governments had the same basic political approach, it was curious that only in Washington was there no sign of effective action to control borrowing. It would of course be important to put the point sympathetically; but it should certainly be put. Dr. Stoltenberg agreed.

Community issues

5. Dr. Stoltenberg said that the change of government in Bonn would not entail any major change in the FRG's Community policies. In particular the approach to the problems of the Community budget would remain precisely the same, with a renewed insistence on no infringement of the 1 per cent VAT ceiling. The ceiling would in fact not be at risk for the next couple of years. The financial consequences of enlargement would need further examination in Bonn, though the new government would continue to support enlargement on political grounds.

6. The Chancellor agreed on the importance of maintaining the 1 per cent ceiling. For the UK, the most pressing Community problem was that of our budget contribution. The Government was strongly committed to Community membership, but the Labour Party was increasingly anti-Community, and its criticisms of the effect on us of the budget arrangements had considerable influence on public opinion. Ten years ago it had been assumed that our budget contribution would decline as agriculture's share in total Community spending fell. But agriculture's share had not fallen.



And it had been accepted in 1972 that if the fall did not occur, an unacceptable situation for the UK would arise, and would have to be considered. The fact was that, apart from the FRG, we were the only net contributor, though by any yardstick we were one of the less prosperous Community countries. If no corrective action had been taken, we would have found ourselves paying a net £1 billion every year. The Community had recognised, in the agreement of 30 May 1980, that some corrective machinery was essential. But the agreement then reached was for only three years, and our concern now was that a satisfactory solution, which would deal with the problem for as long as it might last, remained elusive. The UK and the FRG alone had a clear interest in controlling the overall size of the Community budget, which entailed devising a rational system for resource allocation. And it should be possible to reach mutual agreement on a system involving limits on our two national contributions. The present regime of annual rows was disruptive and distracting for the Community, and damaged its image at home and abroad. We were fully prepared to be a modest net contributor, but we thought it right to seek assurance that our future contributions would be modest, and we thought it reasonable that the two net contributors should together seek an effective system of financial control.

7. Dr. Stoltenberg agreed that a more rational system would be desirable, and should be devised before enlargement. But it would take time. For 1983 another arrangement, along the lines of that just concluded for 1982, would be required to deal with the UK problem. In considering a 1983 arrangement, the new FRG government would maintain the position announced by Herr Genscher on 25 May 1982, i.e. that the German contribution to any refund to the UK would be limited.

8. The Chancellor explained that while we accepted the need for another interim arrangement, we could not accept that it should last only one year. A duration of three, or at least two, years was essential, not least to take the issue out of the political arena in the United Kingdom. If the German contribution to UK refunds were to be limited, the negotiation of a satisfactory agreement



would once again be greatly complicated. Dr. Stoltenberg accepted that a two year agreement would be sensible. He also agreed that a further drive to hold down the costs of the CAP would be desirable, and agreed to a suggestion from the Chancellor for bilateral contacts between Finance Ministry experts to try to identify new methods.

9. The Chancellor referred to the recent CFP agreement, and suggested that pressure be brought to bear on the Danish Presidency to accept it. We were close to a major achievement for the Community, and should not let it slip from our grasp. Dr. Stoltenberg agreed.

IMF issues

10. The Chancellor referred to the need to increase the resources available to the international institutions to assist problem countries. Agreement on increased IMF quotas was due at the end of 1983, to take effect from the end of 1985. At Toronto it had been agreed that this timetable should be accelerated, with a view to reaching decisions at the Interim Committee Meeting then planned for April 1983. With signs of a growing consensus that a 50 per cent increase in quotas would be appropriate, there was now a case for bringing forward the Interim Committee's Meeting. It would of course be necessary to ensure in advance that agreement at the meeting would be reached: to advance it and succeed would be good for confidence; to advance it and fail would be disastrous. The immediate action was to maintain pressure on the Americans to come into line with other G5 views; and simultaneously to work to reduce unrealistically high ldc expectations.

11. Dr. Stoltenberg said that he strongly favoured a substantial increase in IMF quotas. He would have to report to Cabinet, but was already confident that Chancellor Kohl, and Lambsdorff and Genscher, would agree. He accepted the case for bringing forward the Interim Committee Meeting to January or February, and he was ready to repeat his predecessor's invitation to G5 members to a meeting in Germany in January. The Chancellor thought that G5 might have to meet rather earlier. Dr. Schulmann thought that much would depend on whether the Americans would in fact move into line



with the G5 consensus. If Secretary Regan were to focus on the question, he thought they would. But while it was handled by Sprinkel, he remained rather pessimistic. The Chancellor agreed that it was important to maintain pressure on the Americans. He had signalled his willingness to accept the compromise solution worked out by G5 Deputies. (Dr. Stoltenberg indicated that he had not yet done so.) Chancellor Kohl's visit to Washington would be important. (Dr. Stoltenberg indicated that he would not be accompanying Chancellor Kohl.) Early messages, or perhaps visits, to Regan were clearly desirable.

12. Dr. Stoltenberg said that he could see a case for advancing the G5 meeting into December. He would consider the matter further. And he warmly welcomed the candidature of the Chancellor for the Chairmanship of the Interim Committee: it had the FRG's strong support.

13. The meeting ended at 8 p.m.

JOK

J.O. KERR

3 November 1982

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